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No. 73-1185

Supreme Court, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1973

F. PAUL DUFFY AND VIRGINIA H. DUFFY, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ROBERT H. BORK,
Solicitor General.
Department of Justice,
Washington, D.C. 20530.

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Petitioners seek review of the decision of the court of appeals holding that they were taxable upon trust income under Section 677(a)(2) of the Internal Revenue Code of 1954. That provision imposes tax upon the grantor (settlor) of a trust for all trust income that is or may be held or accumulated for future distributuion to the grantor, in the discretion of the grantor or a nonadverse party.[1]

In 1963, petitioners established trusts for the benefit of each of their four children which could have been revoked or amended by petitioners at any time after ten years and thirty days from their creation (Pet. App.

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[1]Although petitioners argued below that the bank-trustee was an adverse party, they have now abandoned this contention. See Section 672(a) for the definition of "adverse party."

39-42). Under the trust instrument, the trustee-bank had sole discretion to accumulate the income or to distribute it for the "education, maintenance or welfare" of each beneficiary (Pet. App. 40). When each child attained the age of twenty-one, the accumulated income was to be added to the trust corpus and thereafter the accruing income was to be distributed to each child (*ibid.*). The trusts were to terminate and all the principal and undistributed income were to be distributed to the children when the youngest child reached twenty-five (Pet. App. 40-41). However, if petitioners revoked the trusts after the ten-year and thirty day term, they could have received the accumulated income of the trust.

Because the trusts could have been revoked by petitioners and the accumulated income might have been distributed to them, Section 677(a)(2) by its terms applies to this case. Petitioners, however, contend (Pet. 9-12) that they qualify under the exception set forth in the last sentence of Section 677(a). That exception provides that:

> This subsection shall not apply to a power the exercise of which can only affect the beneficial enjoyment of the income for a period commencing after the expiration of a period such that the grantor would not be treated as the owner under section 673 if the power were a reversionary interest; but the grantor may be treated as the owner after the expiration of the period unless the power is relinquished.

Petitioners submit that because they could not revoke the trust within ten years of its creation and would not be treated as the owners of the trust under Sec-

tion 673 if the power were a reversionary interest, they are not chargeable with the income of the trust under Section 677(a)(2).

The short answer to this contention is that the above-quoted exception clause applies to a grantor who has a power only over trust income accruing after the expiration of the ten-year period. Under such circumstances, the grantor will not be taxable on trust income accruing prior to the expiration of that period. As the court of appeals correctly recognized (Pet. App. 22-27), however, the exception does not cover this case, where the grantors' power was over trust income earned within the ten-year period.

This interpretation is supported by both the legislative history of the provision and the Treasury Regulations which specifically provide that the exception clause does not exempt a grantor from tax on trust income earned within the ten-year period, if the grantor may receive the accumulated income after the expiration of the period. See S. Rep. No. 1622, 83d Cong., 2d Sess., p. 371; Treasury Regulations, Section 1.677(a)-1(f). To the extent there are other decided cases on this point, they are in agreement with the decision below. See *Humphrey* v. *United States*, 245 F. Supp. 49 (D. Kan.); *Humphrey* v. *Commissioner*, 39 T.C. 199. See Rev. Rul. 57-363, 1957-2 Cum. Bull. 326.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

MARCH 1974.